Supreme Court, U.S.
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No.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1999

ZINSMEYER TRUSTS PARTNERSHIP,
Petitioner,

v.

PAINEWEBBER GROUP, INC.; PAINEWEBBER, INC.;
MITCHELL HUTCHINS ASSET MANAGEMENT, INC.;
and WILLIAM J. REIK, JR.,
Respondents.

On Petition for Writ of Certiorari to the
United States Court of Appeals for the Eighth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED FOR REVIEW

1. Does the intentional concealment of material evidence by a party to an arbitration proceeding constitute "undue means" (and therefore grounds for vacating an arbitrators' award) within the meaning of Section 10(a)(1) of the Federal Arbitration Act, 9 U.S.C. § 10(a)(1)?

2. When a federal district court makes factual findings in vacating an arbitrators' award under Section 10(a)(1) of the Federal Arbitration Act (9 U.S.C. § 10(a)(1) must a federal court of appeals accept those findings unless they are "clearly erroneous"?

3. To vacate an award under the Federal Arbitration Act on the ground that the award was procured through the intentional concealment of evidence, is it sufficient to find that the concealed evidence was materially related to an issue in the arbitration? Or must the district court find that the award would not have been entered *but for* the intentional concealment?

LIST OF PARTIES

The parties are as stated in the caption.

Petitioner Zinsmeyer Trusts Partnership is a partnership made up of trusts, none of which have any corporate affiliations.

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PETITION FOR WRIT OF CERTIORARI

Petitioner Zinsmeyer Trusts Partnership respectfully requests that this Court issue a writ of certiorari to review the judgment of the United States Court of Appeals for the Eighth Circuit in this case.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Eighth Circuit is reported at 187 F.3d 988. (Appendix, p.A-10.) The orders of the United States District Court for the Eastern District of Missouri, vacating the arbitration award and denying the motions to alter or amend the judgment, are not published. (Appendix, pp. A-13, A-51.) The denial of the petition for rehearing en banc and the petition for rehearing by the panel is unofficially reported at 1999 U.S. App. LEXIS 26487. (Appendix, p. A-55.)

JURISDICTIONAL STATEMENT

The judgment of the United States Court of Appeals for the Eighth Circuit was entered on August 16, 1999. (Appendix, p. A-1.) A petition for rehearing or rehearing en banc, timely filed, was denied on October 19, 1999. (Appendix, p. A-55.) The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTE INVOLVED IN THE CASE

Section 10(a) of the Federal Arbitration Act, 9 U.S.C. § 10(a), provides as follows:

§ 10. Same; vacation; grounds; rehearing

> (a) In any of the following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration—
>
> (1) Where the award was procured by corruption, fraud, or undue means.

(2) Where there was evident partiality or corruption in the arbitrators, or either of them.

(3) Where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced.

(4) Where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

(5) Where an award is vacated and the time within which the agreement required the award to be made has not expired the court may, in its discretion, direct a rehearing by the arbitrators.

STATEMENT OF THE CASE

1. ***The Parties.*** The petitioner Zinsmeyer Trusts Partnership (herein referred to as "ZTP") is a substantial investor. The respondents are Mitchell Hutchins Asset Management, Inc. ("Mitchell Hutchins"), an investment advisor and portfolio manager; PaineWebber Incorporated, the parent of Mitchell Hutchins; and PaineWebber Group, Inc., the parent of PaineWebber Incorporated (these three respondents are herein referred to collectively as "PaineWebber"). An additional respondent is William J. Reik, Jr., (herein sometimes referred to as "Reik"); he was an employee of Mitchell Hutchins from before 1986 until February, 1991.[1]

2. ***The Relationship Between the Parties.*** In 1986, ZTP retained Reik and Mitchell Hutchins as investment advisors and

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[1] William D. Witter, Inc., which employed Reik after he left PaineWebber, was a party below, but ZTP has not named it as a respondent in this proceeding.

gave them discretionary authority to invest a significant portion of ZTP's assets. During the next six years, Reik managed the investment of those funds.

3. ***The N.A.S.D. Claim.*** In 1994, ZTP filed a claim for arbitration before the National Association of Securities Dealers, Inc. ("NASD") against respondents PaineWebber, Reik, and others. ZTP alleged that Reik had invested its assets (as well as the assets of his other clients) in the thinly traded stocks of Neutrogena Corp. and two other corporations. ZTP further alleged that Reik used its funds to manipulate the market for Neutrogena Corp. stock and to purchase such stock for its account at inflated prices, and that it had been damaged as a result.

4. ***The Documents.*** In 1990, well prior to the commencement of the arbitration proceeding, three closely related documents were prepared at PaineWebber in the course of a review of Reik's transactions in Neutrogena stock. These were: (i) a handwritten outline of a memorandum reviewing those transactions (Appendix, p. A-56), (ii) a preliminary draft of a portion of the memorandum (the "Preliminary Memorandum") (Appendix, p. A-57), and (iii) the final version of the memorandum (the "Final Memorandum") (Appendix, p. A-63). As more fully described below,[2] the Final Memorandum contained material information concerning Reik's manipulation of the market for Neutrogena stock.

5. ***The Concealment of the Final Memorandum.*** During the arbitration proceedings PaineWebber produced the handwritten outline and the Preliminary Memorandum. *Nevertheless, it categorically denied the existence of the Final Memorandum.* During the examination of a witness before the arbitration panel concerning the Preliminary Memorandum, the following collo-

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[2] See pp. 22-24, *infra*.

quy occurred between counsel for ZTP (Mr. Douglass) and counsel for PaineWebber:

> MR. DOUGLASS: Ken, this is the form document for 179 that was produced to us; all right? If you have a complete copy of the memo and it exists, we would appreciate it being produced.
>
> MR. LYONS: I will just say for the record what we've said many, many times in the course of discovery: That is the only document that exists in the files. You have asked many times for that document. We've verified for you many times that that is all that we have in the files.
>
> MR. DOUGLASS: All right, but in light of Mr. Cavell's testimony, and in light of this memo, I'm asking if there is a III and IV; okay?
>
> MR. HIGGINS: Mr. Cavell didn't tell you there was a III and IV.
>
> MR. DOUGLASS: I understand that. If there is one, I'd like to see it.
>
> MR. LYONS: For the record, I will repeat what we've said many, many times in the past; you have everything that exists in our client's file.

(Appendix, p. A-73.) The statements by PaineWebber's counsel were false. The Final Memorandum did of course exist and it had not been produced. At no time during the arbitration did PaineWebber produce the Final Memorandum, nor did it ever advise the arbitration panel that its counsel's statements were false.

6. ***The Results of the Arbitration.*** On November 30, 1995, the NASD arbitration panel denied ZTP's claims.

*7. **The Commencement of Litigation.*** Still unaware of the existence of the Final Memorandum, ZTP then brought an action in the Circuit Court for St. Louis County, Missouri, to vacate the arbitration award. That action was timely removed to the United States District Court for the Eastern District of Missouri, Eastern Division, on grounds of the existence of a federal question (28 U.S.C. § 1331) and diversity (28 U.S.C. § 1332). After removal, the district court consolidated the case with another action PaineWebber had brought in federal court to confirm the arbitration award.

8. ***The Discovery of the Final Memorandum.*** In other litigation against PaineWebber (based on claims by other investors that Reik manipulated markets), the United States District Court for the Eastern District of Missouri on September 5, 1996, rejected PaineWebber's claims of privilege and ordered it to produce a number of documents, including the Final Memorandum. ZTP learned of the Final Memorandum for the first time when PaineWebber produced it in that other litigation.

9. ***Amendment of Litigation.*** Immediately thereafter, ZTP filed a supplement to its motion in the district court to vacate the arbitration award. The supplement included as grounds that the award had been procured through "undue means" because PaineWebber lied about and improperly concealed the existence of the Final Memorandum and other documents,[3] and that it had thereby intentionally misled both ZTP and the arbitration panel.

10. ***Evidence before the District Court.*** The district court reviewed the handwritten notes, the Preliminary Memorandum,

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[3] One of these documents is a memorandum by Robert Berson of PaineWebber dated February 13, 1991, that was neither produced nor listed in PaineWebber's privilege log. The memorandum describes a conversation between Berson and William Witter and sets forth, *inter alia*, Berson's statement to Witter that "the customer situations involved millions of dollars of potential losses and that *there is reason to believe Reik was primarily responsible for same. . . .* " (Appendix p. A-74; emphasis added.)

the Final Memorandum, the other documents not produced during the arbitration, PaineWebber's response to the charge of concealing evidence, and the transcript of the arbitration proceedings.

11. ***Initial Decision by the District Court.*** As a result of that review, on April 15, 1997, the district court vacated the arbitration award in favor of PaineWebber and Reik. (Appendix, p. A-13.) It found, *inter alia*, that the record "clearly shows" that the Final Memorandum and other documents "*were hidden by PaineWebber and kept from [ZTP's] discovery during the arbitration.*" (Appendix, p. A-45; emphasis added.) It further found that PaineWebber and its counsel "*improperly withheld documents from discovery. The record evinces bad faith and misconduct in withholding such discovery.*" (Appendix, p. A-45; emphasis added.)

The district court also rejected PaineWebber's argument that the award should be confirmed because the concealed evidence would not have changed the outcome of the arbitration. The district court held that it was "not required to reweigh the evidence in light of the withheld documents and evidence." (Appendix, p. A-46.) Instead, the court held that it "need only conclude that there be some causal relation between the conduct and that party's obtaining the arbitration award." (Appendix, p. A-46.) The district court found that the concealed documents were material and relevant to ZTP's claims. "As such, their absence undoubtedly impacted on [ZTP's] ability to pursue its case and examine key witnesses; their absence could certainly have impacted the decision making process of the arbitrators." (Appendix, p. A-47.)

12. ***The District Court's Decision on Motion to Alter or Amend.*** In denying motions to alter or amend its judgment, the district court on January 29, 1998, found: "PaineWebber's mischaracterization of its behavior . . . by describing its conduct

. . . as unintentional and incidental *is in direct conflict with the record* and the Court's conclusions." (Appendix, p. A-53; emphasis added.)

13. ***Decision by the Eighth Circuit.*** On appeal, the Court of Appeals for the Eighth Circuit reversed. (Appendix, p. A-1.) Without discussing the appropriate scope of appellate review (or even mentioning the "clearly erroneous" standard of Rule 52(a) of the Federal Rules of Civil Procedure), the Court of Appeals reviewed the decision of the district court *de novo.* It held that PaineWebber's "mistakes" were not the kind of intentional misconduct that constitutes "undue means" under 9 U.S.C. § 10(a)(1). (Appendix, p. A-8.)

As an additional ground, the court also held that even if PaineWebber's "mistakes" constituted "undue means," there was no showing that there was a sufficient causal connection between those "mistakes" and the award. (Appendix, p. A-10.) The court based this holding on its assumption that the arbitration panel would have upheld a claim of privilege by PaineWebber as to the Final Memorandum. It assumed that even if ZTP had known of the existence of that memorandum it could not have compelled its production. (Appendix, p. A-10.) As a third ground for its decision, the court further held that ZTP failed to show that the evidence before the arbitration panel would have been any different if ZTP had received the full text of the Final Memorandum at the outset of the arbitration. (Appendix, p. A-10.)

14. ***Denial of Motion for Rehearing.*** On October 19, 1999, the Court of Appeals denied ZTP's motion for rehearing and rehearing en banc, Judge McMillian dissenting. (Appendix, p. A-55.)

ARGUMENT

1. Does intentional concealment of material evidence by a party to an arbitration proceeding constitute "undue means" (and therefore grounds for vacating an arbitrators' award) within the meaning of Section 10(a)(1) of the Federal Arbitration Act, 9 U.S.C. § 10(a)(1)?

In the last two decades, arbitration has become a significant alternative to litigation for the resolution of disputes. In 1998 the National Association of Securities Dealers, Inc. ("NASD") administered the arbitration of 1,918 cases.[4] Most of these NASD cases involved claims based on federal securities law, and they would have been filed in federal district courts if they were not arbitrated. Additional arbitration cases involving the federal securities laws were administered by the New York Stock Exchange. In addition, thousands of other disputes were resolved through arbitration not administered by the NASD or the New York Stock Exchange.[5] It is impossible to ascertain how many of these other arbitrations would be within the jurisdiction of the federal district courts, but the number is almost certainly in the thousands and perhaps in the tens of thousands.

During 1998, fewer than 9,500 civil cases were tried in federal district courts.[6] Thus, the number of civil disputes resolved through private arbitration is of at least the same order of magnitude as the number of civil disputes tried in the federal judicial system. If the disputes that are now resolved through

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[4] National Association of Securities Dealers, Inc., Annual Report 1998, page 28. During 1998, 4,938 cases were filed with the NASD. As with the federal courts, many more cases are filed with the NASD than are tried.

[5] In 1998 a total of 92,100 arbitration cases were filed with the American Arbitration Association. American Arbitration Association, Annual Report 1998, page 23. Of course, many other arbitrations are not administered by any organization.

[6] Judicial Business of the United States Courts 1998, page 30.

arbitration were to be litigated, the caseload of our already overburdened federal judicial system would be significantly increased.

The growth and importance of arbitration as a significant adjunct to the federal judicial system is reflected in the decisions of this Court. In *Wilko v. Swan*, 346 U.S. 427 (1953), the Court held that an agreement by a customer of a securities dealer to arbitrate all future disputes was unenforceable. Underlying its decision was a lack of confidence that the rights conferred by the federal Securities Act of 1933, 15 U.S.C. § 77a *et seq.* would be adequately protected in arbitration. *Id.* at 437. By 1987, however, the Court's confidence in the adequacy of arbitration had increased substantially. In *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220 (1987), the Court refused to extend the holding in *Wilko* to predispute agreements to arbitrate claims arising under the Securities and Exchange Act of 1934 15 U.S.C. § 78a *et seq.*, as amended. Justice O'Connor, writing for the majority, stated that "*Wilko* must be read as barring a waiver of a judicial forum only where arbitration is inadequate to protect the substantive rights at issue." *Id.* at 229. She went on to note that in 1975 the arbitration rules of the securities industry's self-regulatory organizations became subject to oversight by the Securities and Exchange Commission, and that the Commission had approved the arbitration rules of the NASD, the New York Stock Exchange, and the American Stock Exchange. She concluded that, under these changed circumstances, arbitration was adequate to protect the important federal rights of investors conferred by the 1934 Act. *Id.* at 233-34. Her conclusions were reiterated in *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477 (1989), where a divided Court overruled *Wilko.*

None of these three decisions was unanimous. The divisions in the Court reflect the tensions between two strong federal policies. One policy is embodied in the Federal Arbitration Act;

it favors enforcement of agreements to resolve disputes through arbitration rather than litigation. The other policy is reflected in the Securities Act of 1933, the Securities Exchange Act of 1934 and other federal securities laws; it favors protection of investors and the integrity of the securities markets. The resolution of this tension requires that the arbitration system have sufficient integrity to ensure that investors receive a fair hearing.

There is, therefore, a strong federal interest in maintaining and improving the arbitration process. At the same time, however, the courts need to be cautious about excessive intrusion into the arbitration process. In short, there needs to be a balance. The courts need to intervene when it is necessary to preserve the integrity of the arbitration process — to ensure that arbitration remains an adequate method of protecting important federal statutory rights. A court, however, should not intervene simply because it believes the arbitrators in a particular case reached the wrong result. The courts need not undertake to correct the honest mistakes of arbitrators.

Congress established the mechanism for achieving the necessary balance in the Federal Arbitration Act, 9 U.S.C. § 1 *et seq.* Section 10(a) of that Act lists the grounds on which a federal district court may vacate an arbitral award. Under the statute a court may vacate an arbitrators' award:

(1) Where the award was procured by corruption, fraud, or undue means.

(2) Where there was evident partiality or corruption in the arbitrators, or either of them.

(3) Where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced.

(4) Where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

These statutory grounds all relate to the integrity of the process of arbitration. They do not relate to the question of whether the arbitrators made the right decision. They concern, rather, the fairness and integrity of the process and the tribunal.

This focus on process rather than result is also shown in the only decision of this Court vacating an arbitrators' award, *Commonwealth Coatings Corp. v. Continental Casualty Co.*, 393 U.S. 145 (1968). That case involved a claim by a subcontractor against a prime contractor. Each party appointed one arbitrator, and those two together selected the third arbitrator. That third arbitrator had a business relationship with the prime contractor that neither he nor the prime contractor disclosed to the subcontractor. The arbitrators found for the prime contractor, and both the federal district court and the United States Court of Appeals for the First Circuit refused to vacate the award. This Court, however, directed that the arbitrators' award be vacated. Justice Black wrote the majority opinion:

> Section 10 [of the Federal Arbitration Act] sets out the conditions upon which awards can be vacated. The two courts below held, however, that § 10 could not be construed in such a way as to justify the vacating of the award in this case. We disagree and reverse. Section 10 does authorize vacation of an award where it was "procured by corruption, fraud, or undue means". . . .

393 U.S. at 147.

Justice Black went on to note:

> It is true that petitioner does not charge before us that the third arbitrator was actually guilty of fraud or bias in

> deciding this case, and we have no reason, apart from the undisclosed business relationship, to suspect him of any improper motives. But neither this arbitrator *nor the prime contractor* gave to petitioner even an intimation of the close financial relations that had existed between them for a period of years.

Id. at 147-48 (emphasis added).

Justice Black imposed a duty of disclosure not only on the third arbitrator but also on the prime contractor. The nondisclosure by the prime contractor was thus deemed to constitute "undue means" within the meaning of § 10(a)(1) of the Federal Arbitration Act.

Thus, the general rule is clear: Judicial intervention is warranted if the arbitration process is tainted by fraud, corruption, undue means, biased arbitrators, or the like; bona fide errors of fact or law by the arbitrators, however, do not justify judicial intervention. *See Flexible Manufacturing Systems Pty. Ltd. v. Super Products Corp.*, 86 F.3d 96, 99-100 (7th Cir. 1996).

Although the general rule is clear, its application to specific cases is nevertheless largely uncharted. What constitutes "undue means" within the meaning of Section 10(a)(1) of the Federal Arbitration Act and *Commonwealth Coatings*? In the statute the phrase "undue means" is harnessed with "fraud" and "corruption," and its meaning therefore may be colored by those terms. Some wrongfulness, immorality, or bad faith may be a required ingredient of "undue means." *A.G. Edwards & Sons, Inc. v. McCollough*, 967 F.2d 1401 (9th Cir. 1992), *cert. denied*, 506 U.S. 1050 (1993); *see also American Postal Workers Union v. U.S. Postal Service*, 52 F.3d 359, 362 (D.C. Cir. 1995); *Trans Chemical Ltd. v. China Nat. Mach. Import & Export Corp.*, 978 F. Supp. 266, 304 (S.D. Tex. 1997), *aff'd*, 161 F.3d 314 (5th Cir. 1998). These cases do not address the question of whether intentionally lying to the arbitration panel (and opposing coun-

sel) about the existence of a relevant document is sufficiently wrongful, immoral, or lacking in good faith to constitute "undue means" within the meaning of the statute.

Closer in point is *Bonar v. Dean Witter Reynolds*, 835 F.2d 1378 (11th Cir. 1988). In that case, the expert witness for the claimants lied about his qualifications at the hearing before the arbitrators. The arbitrators held for the claimants, and they awarded punitive damages against Dean Witter. The evidence supporting the punitive damages award was primarily the expert's testimony. After the award Dean Witter discovered the expert's perjury and asked the district court to vacate the award. Although the claimants admitted their expert's perjury, the district court confirmed the award without opinion. The Eleventh Circuit reversed, holding that the expert's perjury was "fraud" within the meaning of Section 10(a)(1). It held that Dean Witter was entitled to a new hearing before different arbitrators on the issue of punitive damages.

This case is like *Bonar*. In this case the district court explicitly found that PaineWebber had acted in "bad faith" and was guilty of "misconduct." Do these findings support the district court's decision to vacate the award on the ground that PaineWebber procured the arbitrators' award by "undue means"? This Court should issue its writ of certiorari in this case to resolve that question.

There are, of course, many good reasons[7] why the Court could hold that deliberately concealing and lying about the existence of material evidence in an arbitration constitutes "undue means" within the meaning of the statute:

- Such concealment taints the arbitration process.

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[7] These arguments are here merely suggested and not developed. It would be premature to develop them fully at this stage of these proceedings. If and when the Court issues its writ of certiorari, the merits can be fully briefed.

- Most people would refuse to arbitrate if they knew their opponents could hide incriminating evidence with impunity.
- No one would view the arbitrators' award as fair if they knew that the prevailing party had prevented the arbitrators from obtaining full knowledge of the relevant facts.
- The prevailing party should not be allowed to profit from its misdeeds.
- If both sides concealed material evidence, discovery in arbitration would become a mockery, and arbitrations would have to proceed without meaningful discovery.
- When the parties have agreed to arbitrate pursuant to specific rules — in this case rules that explicitly provide for discovery — the parties should not be permitted to ignore those rules. *See Gateway Technologies, Inc. v. MCI Telecommunications Corp.*, 64 F.3d 993, 996-97 (5th Cir. 1995).

Permitting judicial review of the conduct of the parties during discovery in arbitration has some costs. It could lead to an increase in the number of actions seeking to vacate arbitrators' awards, with a concomitant expenditure of judicial time and effort that could otherwise be devoted to other tasks. Increased judicial supervision of arbitration could diminish the anticipated savings in costs and time that make arbitration attractive in many situations.

Thus, the question presented by this petition comes down to a balancing of risks. Does

(a) the threat to the integrity and adequacy of the arbitration process arising from permitting a party intentionally to conceal material evidence and to lie about that evidence

outweigh

> (b) the risks of increased litigation and accompanying dissipation of judicial energy arising from permitting judicial intervention to set aside awards procured by such concealment and mendacity?

In this case, the Eighth Circuit did not properly balance the competing interests. It stretched to reverse the district court and uphold the arbitrators' award. It gave undue weight to a supposed federal policy of upholding such awards. This Court has already rejected the view that the review of arbitrators' awards should be tilted in favor of confirming awards. *First Options of Chicago, Inc. v. Kaplan,* 514 U.S. 938, 947-49 (1995). This Court should reaffirm that ruling by granting certiorari and reversing the court of appeals' decision in this case.

Viewed from a slightly different angle, the question in this case becomes: Is *Commonwealth Coatings* the controlling authority for this case? Is this case so different from *Bonar* that its ultimate result should be different? These are important questions of federal law that have not been, but should be, settled by this Court.

2. When a federal district court makes factual findings in vacating an arbitrators' award under Section 10(a)(1) of the Federal Arbitration Act (9 U.S.C. § 10(a)(1)), must a federal court of appeals accept those findings unless they are "clearly erroneous"?

Rule 52(a) of the Federal Rules of Civil Procedure provides in part that "Findings of fact [by a district court], whether based on oral or documentary evidence, shall not be set aside unless clearly erroneous. . . ." This Court adopted the same standard of review in *Anderson v. City of Bessemer City,* 470 U.S. 564 (1985). In *First Options of Chicago, Inc. v. Kaplan,* 514 U.S.

938, 947-49 (1995), this Court approved the "clearly erroneous" standard of review in a case involving a district court's factual finding that the parties had not agreed to arbitration.

Moreover, at least three federal Courts of Appeals have held that the "clearly erroneous" standard of Rule 52(a) applies to the review of findings of fact made by a district court in vacating or confirming an arbitral award. *Wackenhut Corp. v. Amalgamated Local 515*, 126 F.3d 29, 31 (2d Cir. 1997); *Barnes v. Logan*, 122 F.3d 820, 821 (9th Cir. 1997), *cert. denied*, 523 U.S. 1059 (1998); *Kelley v. Michaels*, 59 F.3d 1050, 1053 (10th Cir. 1995).

Nevertheless, in this case the Court of Appeals for the Eighth Circuit ignored Rule 52(a). It did not cite the Rule nor even discuss the scope of its review of the district court's decision. It did not cite or discuss *Anderson v. City of Bessemer City* or *First Options of Chicago, Inc. v. Kaplan*. The words "clearly erroneous" do not appear in its opinion. Not only was Rule 52(a) not mentioned, it was not applied. The Court of Appeals simply substituted its own view of the facts for that of the district court.

The district court reviewed the transcript of the hearing before the arbitration panel, the Final Memorandum, and the other documents in question. The transcript included the denial by PaineWebber's counsel that the Final Memorandum existed. The district court also deemed inadequate PaineWebber's response to the charge that it had improperly concealed the Final Memorandum:

> In their response to [ZTP's] supplemental memorandum, PaineWebber does not contest that this document was not produced by them; it asserts only the matters discussed in this document were not central or relevant to [ZTP's] case and would not have made a difference in the outcome of the arbitration.

(Appendix, p. A-45.) In short, in its response PaineWebber did not deny that it had lied. It argued only that no prejudice to ZTP resulted from its deceptions.

After its review of this documentary evidence, the district court found that the record "clearly shows" that the Final Memorandum and other documents "were hidden by PaineWebber and kept from [ZTP's] discovery during the arbitration." It further found that PaineWebber and its counsel "improperly withheld documents from discovery. The record evinces bad faith and misconduct in withholding such discovery." (Appendix, p. A-45.) These are clearly findings of fact made after a review of the documentary evidence.

The district court reiterated its factual findings in its order denying respondents' motions to alter or amend its judgment. It there found: "PaineWebber and Reik submit that the evidence before Court does not support a finding of intentional misconduct. . . . *PaineWebber's mischaracterization of its behavior . . . as unintentional and incidental is in direct conflict with the record and the Court's conclusions.*" (Appendix, pp. A-45, A-46; emphasis added.)

On appeal, the Court of Appeals for the Eighth Circuit reversed. Without discussing the appropriate scope of appellate review, the Court of Appeals reviewed the decision of the district court *de novo.* Its view of the evidence was remarkably different from that of the district court. It found that PaineWebber's "mistakes" were not the kind of intentional misconduct that constitutes "undue means" under 9 U.S.C. § 10(a)(1). It regarded the false denial of the existence of the Final Memorandum and other concealment of evidence as "the kinds of errors and oversights that are apt to attend the process of claiming privilege for a large group of documents." (Appendix, p. A-8.)

The striking difference between how the district court viewed the facts and how the Court of Appeals viewed those facts

stemms from their different answers to the same fundamental question. That fundamental question is:

> *Did counsel for PaineWebber know of the existence of the Final Memorandum when he denied that it existed?*

This is a question of fact. The district court, after reviewing of the documentary evidence and noting that PaineWebber had made no attempt to explain its counsel's statement, answered that question clearly and in the affirmative. It expressly found that PaineWebber's conduct was not unintentional. (Appendix, p. A-45.)

The district court's finding on this factual issue is not clearly erroneous. The denial by PaineWebber's counsel was not a casual mistake. By his own admission, he had denied the existence of the Final Memorandum "many, many times." Indeed, he even repeated the phrase "many, many times." Moreover, it is unlikely that counsel was truly unaware of such a "smoking gun."

The district court found the facts to be that "PaineWebber and its counsel overstepped" the proper bounds of zealous representation and "improperly withheld documents from discovery." (Appendix, p. A-45.) It found bad faith and misconduct. It found that PaineWebber's conduct was not unintentional. Its findings should not have been set aside by the Court of Appeals. *See Anderson v. City of Bessemer City,* 470 U.S. 564 (1985).

The issue of counsel's mendacity should not be confused with the issue of privilege. At the hearing before the arbitrators, counsel for PaineWebber was asked about the existence of the Final Memorandum. He did not assert a claim of privilege. Rather, he falsely stated that it did not exist. Falsehood and privilege are separate and distinct issues.

The Final Memorandum was listed among almost 2000 entries in PaineWebber's 347-page privilege log. It was not

described there in a way that disclosed or even hinted that it was the final version of the Preliminary Memorandum, and consequently ZTP did not move to compel production of the document as described in the privilege log. Nevertheless, as counsel for PaineWebber admitted, ZTP did ask for production of the Final Memorandum, or at least an acknowledgement of its existence, "many, many times."

When asked about the Final Memorandum, counsel for PaineWebber could have, and clearly should have, simply replied that the document did exist and that it was privileged. That would have been honest and forthright, but that is not what he did. Rather, he denied that it existed. He thereby precluded further efforts by ZTP to obtain a copy of the Final Memorandum or make any challenge to PaineWebber's claim of privilege. In these circumstances, the fact that PaineWebber had a vague entry in its privilege log referring to the Final Memorandum does not excuse its counsel's falsehoods. Counsel cannot deliberately deny the existence of a highly relevant and incriminating document merely because he believes the document may be privileged.

The district court found, based on the documentary evidence, that PaineWebber acted in bad faith. The Eighth Circuit reviewed that finding of fact *de novo*. In so doing it may have adopted the double standard approach that the Eleventh Circuit had used in *Robbins v. Day,* 954 F.2d 679 (11th Cir. 1992), *i.e.*, reviewing district court decisions that vacate arbitration awards more rigorously than decisions confirming awards. This Court, however, rejected that double standard in *First Options of Chicago, Inc. v. Kaplan,* 514 U.S. 938 (1995).

In any event, the Eighth Circuit did not use the "clearly erroneous" standard mandated by Rule 52(a). On the important federal question of whether that standard is applicable to district court decisions vacating arbitrators' awards, the decision of the

Court of Appeals for the Eighth Circuit in this case is in conflict with the decisions of the other United States Courts of Appeals. The Court should issue its writ of certiorari to resolve this conflict among the Circuits.

3. To vacate an award under the Federal Arbitration Act on the ground that the award was procured through the intentional concealment of evidence, is it sufficient to find that the concealed evidence was materially related to an issue in the arbitration? Or must the district court find that the award would not have been entered *but for* the intentional concealment?

The Eighth Circuit also held in this case that ZTP had failed to show any causal connection between (a) the false statements by PaineWebber's counsel and (b) the decision of the arbitrators. It reasoned that even if ZTP had known of the existence of the Final Memorandum, it could not have procured a copy of it because the arbitrators would have upheld PaineWebber's claim of privilege. "Therefore, [ZTP] has failed to prove that PaineWebber's errors in the privileged document process, even if intentional and therefore a form of undue means, 'procured' the arbitration award." (Appendix, p. A-10.)

There are multiple defects in this line of reasoning. It ignores, *inter alia,* the ruling of a federal district court in related litigation rejecting PaineWebber's claim of privilege with respect to the Final Memorandum. That is how ZTP finally learned of its existence and received a copy. If a federal court denied the privilege, it is reasonable to conclude that the arbitrators would have done likewise.

Furthermore, it is the party that is guilty of the misconduct that should bear the burden of showing a lack of causal connection between the misconduct and the result. Otherwise, the wrongdoer may well profit from his own wrongdoing.

Moreover, where as here the arbitrators followed the common practice of expressing no reasons for their award, it is well-nigh impossible to show what would have (as opposed to what reasonably might have) caused them to reach a different result. In this context, the imposition of a "but-for" causation test is equivalent to reading Section 10(a)(1) out of the Federal Arbitration Act; no one could ever show causation with that degree of certainty.

Finally, and most importantly, the Eighth Circuit's decision is contrary to the controlling precedent set by this Court in *Commonwealth Coatings Corp. v. Continental Casualty Co.*, 393 U.S. 145 (1968), discussed above. There this Court vacated the arbitrators' award even though there was no showing that the undisclosed relationship between the prime contractor and the arbitrator "procured" the award. It did not impose on the losing party the impossible burden of showing the result would have been different if the undisclosed facts had been disclosed. Thus, the Eighth Circuit decided this important federal question in a way that conflicts with the relevant decision of this Court.

The foregoing, by itself, would be sufficient grounds for this Court to issue its writ of certiorari. Nevertheless, it may be worth demonstrating that on this important federal question the decision of the Eighth Circuit conflicts with the decision of at least one other Court of Appeals on that same federal question. *Dogherra v. Safeway Stores, Inc.*, 679 F.2d 1293, 1297 (9th Cir.), *cert. denied*, 459 U.S. 990 (1982), held that a party seeking vacation of an arbitrators' award under Section 10(a)(1) of the FAA need not prove "but-for" causation. His burden is lighter; he must show only that the fraud was materially related to an issue in the case: "The fraud must materially relate to an issue in the arbitration." *Id.* This description of the requisite causation was approved in *Gingiss International, Inc. v. Bormet*, 58 F.3d 328, 333 (7th Cir. 1995); *A.G. Edwards & Sons, Inc. v. McCollough*, 967 F.2d 1401 (9th Cir. 1992), *cert. denied*, 506

U.S. 1050 (1993); *Bonar v. Dean Witter Reynolds, Inc.*, 835 F.2d 1378, 1383 (11th Cir. 1988).

The Final Memorandum was materially related to several issues in the arbitration.[8] One of the issues in the arbitration was whether Reik had manipulated the market for the shares of Neutrogena. The Final Memorandum reviewed "the activity in Neutrogena stock" by Reik. It noted that on April 18 and 19, 1990, Reik purchased a total of 124,000 shares of Neutrogena stock. It noted that order tickets for these substantial Neutrogena purchases by Reik were not processed until the day before settlement, that Reik did not time stamp order tickets for Neutrogena purchases, and that it was impossible to tell when such orders were entered or executed. (Appendix, p. A-66.) It recognized that this practice gave rise to "significant questions" not only because it violated applicable regulations but also because it permitted Reik to "warehouse" significant positions. "The ability to absorb selling pressure is also enhanced when additional time to locate purchasers is thus made available." (Appendix, p. A-67.) This information is obviously relevant to ZTP's claim of market manipulation.

In its "Conclusion," the Final Memorandum recommended that Reik be prohibited from making any additional purchase transactions in Neutrogena. The Final Memorandum also recommended "a review of the overall nature and attendant risks of Reik's investment style, especially as related to the trading practices employed in the securities of issuers [such as Neutrogena] where a substantial position is owned." (Appendix, p. A-72.) As a result of that compliance review, Reik's employment was terminated.

It is clear from the foregoing that the Final Memorandum was "materially related" to an issue in the arbitration. That is

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[8] If PaineWebber had not thought the Final Memorandum was important, it would not have lied about its existence.

sufficient to meet the causation requirements imposed by *Dogherra* and more than sufficient to meet the requirements imposed by *Commonwealth Coatings.*

Nevertheless, in a variation on the "but-for" theme, the Eighth Circuit held, without reference to the record, that (in its view) the information in the Final Memorandum was merely cumulative. It concluded, therefore, that ZTP failed to show the requisite causal connection between the concealment of the Final Memorandum and the result reached by the arbitrators:

> The documents appear to add little to the evidence presented during the thirty-eight day hearing [*sic*] regarding Reik's trading activities and PaineWebber's investigation of those activities. . . . But [ZTP] fails to show how production of those four documents would have resulted in additional *facts* being presented to the arbitration panel. For this reason, too, [ZTP] failed to prove that the alleged undue means procured the arbitrators' award.

(Appendix, p. A-10, A-11; emphasis in original.) As shown above, this imposition of a "but-for" test is inconsistent with *Commonwealth Coatings* and *Dogherra*.

Moreover, the Final Memorandum was relevant and important for reasons other than the information it contained about Reik's manipulative conduct. Richard Englehardt was an important witness at the arbitration hearings. He is a former PaineWebber compliance officer who had investigated Reik's activities while at PaineWebber. He is identified in the Final Memorandum as one of the people who compiled the information set forth therein. (Appendix, p. A-63.) He testified before the arbitrators that he believed Reik had manipulated the market for Neutrogena. A critical issue in the case therefore was Englehardt's credibility. Indeed, counsel for PaineWebber tried hard to establish that Englehardt was a lone, rogue voice whose conclusions were not shared by anyone at PaineWebber. Many

of the facts and conclusions that Englehardt had developed during his investigation and testified to during the arbitration, however, are set forth in the Final Memorandum as the views of PaineWebber's management; *i.e.*, its compliance director Mark Commander and the general counsel of Mitchell Hutchins Mary Joan Hoene. If ZTP had had a copy of the Final Memorandum, this endorsement of Englehardt's findings by PaineWebber's management could have been used as evidence to convince the arbitrators of Engelhardt's credibility.

Bill Cavell, another PaineWebber compliance officer who testified at the arbitration hearings, is also listed in the Final Memorandum as one of the sources of the information set forth therein. (Appendix, p. A-63.) During his testimony, Cavell denied that PaineWebber had concluded that Reik engaged in market manipulation. If counsel for ZTP had had a copy of the Final Memorandum when he interrogated Cavell during the arbitration, that interrogation might well have been more effective.

Finally, the Final Memorandum is significant not only for the information it contains but also as evidence that PaineWebber's top management had knowledge of Reik's improper activities as early as June, 1990. This fact is relevant to PaineWebber's liability for Reik's activities.

To summarize, in this case the Eighth Circuit held that PaineWebber's intentional concealment of evidence would not justify vacating the arbitrators' award because ZTP did not show that but for the concealment it would have prevailed in the arbitration. That is an inappropriate test, as shown by both *Commonwealth Coatings* and *Dogherra.* This Court should issue its writ of certiorari both to correct the Eighth Circuit's reading (or lack thereof) of *Commonwealth Coatings*, and to resolve the conflict between the Eighth Circuit's decision in this case and that of the Ninth Circuit in *Dogherra.*

CONCLUSION

This case presents three separate but related questions, any one of which justifies the issuance by this Court of its writ of certiorari.

The first question is whether the intentional concealment of evidence by a party during an arbitration proceeding is grounds for vacating an award made in favor of the concealing party, *i.e.*, is such intentional concealment "undue means" within the meaning of Section 10(a)(1) of the Federal Arbitration Act? This question goes to the heart of the integrity of the arbitration process, and its adequacy to protect the federal statutory rights of investors. This question is already very important, and it will become even more important as the number of cases resolved through arbitration increases. Should the courts permit parties to arbitration proceedings to lie with impunity about the existence of material evidence? Will the value of arbitration as a valuable supplement to both the federal and state judicial systems be undermined because there is no remedy for such mendacity? Do the obvious benefits of providing such a remedy outweigh its costs? These are questions that this Court is uniquely capable of answering.

The second important question concerns the roles of district courts and federal appellate courts in the review of arbitral awards. Generally, facts as found by a district court, whether on oral testimony or documentary evidence, must be accepted by a federal appellate court unless those findings are clearly erroneous. This familiar general rule is embodied in Rule 52(a) of the Federal Rules of Civil Procedure. Is the review of awards under section 10(a) of the Federal Arbitration Act so different from other forms of litigation that Rule 52(a) is not applicable? That is the second important federal question presented by this case. The district court found that PaineWebber was guilty of misconduct and had concealed evidence. Without discussing, citing, or following Rule 52(a), *Anderson v. City of Bessemer City*, or *First*

Options of Chicago, Inc. v. Kaplan, the Eighth Circuit substituted its own interpretation of the record. Because it ignored Rule 52(a) and this Court's rulings, the decision of the Eighth Circuit in this case is in conflict with the decisions of the Second Circuit in *Wackenhut Corp. v. Amalgamated Local 515, supra*; of the Ninth Circuit in *Barnes v. Logan, supra;* and the Tenth Circuit in *Kelley v. Michaels, supra.* This Court should issue its writ of certiorari to resolve these conflicts.

The third important federal question presented by this case concerns the burden of proof of causation in cases under section 10(a)(1) of the Federal Arbitration Act. Does the party seeking to vacate an award on grounds of fraud, corruption, or undue means have the burden of showing that but for such misconduct the award would have been different? In *Commonwealth Coatings* this Court expressly noted the absence of any showing of "but-for" causation, but it nevertheless vacated the arbitrators' award. In this case, the Eighth Circuit reversed the district court on the ground that ZTP had failed to prove "but-for" causation. Its holding on this point is in conflict not only with this Court's decision in *Commonwealth Coatings* but also with the decision of the Fifth Circuit in *Dogherra v. Safeway Stores, Inc., supra.* The resolution of these conflicts is yet another reason why this Court should issue its writ of certiorari in this case.

Any one of these three important federal questions would support the issuance by this Court of its writ of certiorari. Considerations of judicial efficiency strongly suggest that it resolve all three in this action.

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